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IN THE
Supreme Court of the United States

OCTOBER TERM, 1922

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No. 727
—

NORFOLK SOUTHERN RAILROAD COMPANY,
Appellant,
against

A. D. WATTS, COMMISSIONER OF REVENUE, AND
JAMES S. MANNING, ATTORNEY GENERAL OF
THE STATE OF NORTH CAROLINA,
Appellees.

—
BRIEF ON BEHALF OF APPELLANT
—

W. B. RODMAN, *Counsel.*

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BRIEF ON BEHALF OF APPELLANT

STATEMENT OF CASE

Plaintiff, a Virginia corporation, operating a line of railroad, situate in the states of Virginia and North Carolina, filed its bill in the District Court of the United States for the Eastern District of North Carolina, against A. D. Watts, Commissioner of Revenue, and James S. Manning, Attorney General of the State (who, under the laws of the State, are charged with the duty of collecting income taxes authorized by Schedule D, Chapter 34, Public Laws, 1921, as amended), seeking to have the collection of the tax assessed against plaintiff enjoined upon the ground that the statute and the assessment of the tax against plaintiff made thereunder are illegal and void, as being in contravention of the Constitution

of the United States, Article 1, Section 8 (the Commerce Clause), the XIV Amendment, and the State Constitution, Article V, Sec. 3.

Plaintiff asked for a restraining order, pending final hearing, it being inconvenient for three judges to assemble, as required by Sec. 266 of the Judicial Code, by consent the cause was set down for final hearing upon complaint, answer, and affidavits.

From a final decree, dismissing the bill, plaintiff appealed direct to this Court, under the provisions of Sec. 238 of the Judicial Code.

STATEMENT OF QUESTIONS INVOLVED

The power of the State to tax the "net income" of plaintiff is not denied; that power is admitted.

The pleadings admit, if plaintiff is allowed to deduct from its gross income the same items of expense and losses as are allowed all other tax payers, plaintiff has no income subject to taxation.

(Section 17 of Complaint and Answer.)

The questions involved are two:

(1) The power of the State to tax, the revenues which plaintiff receives from the operation of its railroad property in interstate commerce, after deducting therefrom the cost of operation, uncollectable railway revenue, and taxes, increasing or decreasing this balance by the credit or debit balance of its car hire account.

(2) The power of the State to classify income tax payers based upon the manner in which they are required to keep their records.

ASSIGNMENTS OF ERROR

The assignments of error are set out in full in Appendix A.

Briefly, they are, that the statute authorizing the tax, and

the assessment of the tax, is illegal, as being in contravention of the Constitution of the United States, for that :

(1) They are in contravention of Article 1, Sec. 8 of the Constitution of the United States (the commerce clause).

(2) They are in contravention of the XIV Amendment to the Constitution of the United States.

(3) They are in contravention of the Constitution of the State, Article V, Sec. 3.

(4) That the Court erred in denying the injunction and dismissing the bill.

ARGUMENT

PART I

JURISDICTION

The appropriate and necessary averments as to diversity of citizenship and amount in controversy are made and not denied; privileges and immunities under the Constitution of the United States are set up and alleged to be violated.

The answer denies that this is a suit in equity arising under the Constitution and laws of the United States, and denies that matters are involved arising under the Constitution and laws of North Carolina.

The bill alleges and the answer admits that the law which is attacked undertakes to classify corporations for the purpose of ascertaining the deductions which corporations may make from their gross income in order to ascertain their net income subject to taxation. (Section 26 of bill and answer.)

It is alleged that this classification is arbitrary and without any real foundation, having no fair or substantial relation to the proper object sought to be accomplished by the legislation, and that the result of such classification is to unduly burden and regulate interstate commerce, that this violates the commerce clause and the Fourteenth Amendment of the Federal Constitution as well as the Constitution of the State.

That this raises questions under the Federal Constitution as well as under the State Constitution cannot be denied.

Jurisdiction exists on the ground of diverse citizenship, as well as that a Federal question is involved.

UNDER THE STATE STATUTES, A COURT OF EQUITY IS AUTHORIZED TO ENJOIN, BOTH PENDENTE LITE AND UPON FINAL HEARING, THE COLLECTION OF A TAX ALLEGED TO BE ILLEGAL AND VOID, AND TAX PAYER IS NOT REQUIRED TO PAY THE TAX AND SUE AT LAW TO RECOVER IT BACK, ALTHOUGH HE MAY DO SO.

Consolidated Statutes, Sec. 7979:

"Unless a tax or assessment, or some part thereof, be illegal or invalid, or be levied or assessed for an illegal or unauthorized purpose, no injunction shall be granted by any court or judge to restrain the collection thereof in whole or in part, nor to restrain the sale of any property for the nonpayment thereof; nor shall any court issue any order in claim and delivery proceedings or otherwise for the taking of any personalty levied on by the sheriff to enforce payment of such tax or assessment against the owner thereof. Whenever any person shall claim to have a valid defense to the enforcement of a tax or assessment charged or assessed upon his property or poll, such person shall pay such tax or assessment to the sheriff; but, if, at the time of such payment, he shall notify the sheriff in writing that he pays the same under protest, such payment shall be without prejudice to any defenses or rights he may have in the premises, and he may at any time within thirty days after such payment, demand the same in writing from the treasurer of the State or of the county, city or town, for the benefit or under the authority or by request of which the same was levied; and if the same shall not be refunded within ninety days thereafter, may sue such county, city or town for the amount so demanded, including in his action against the county both state and

county tax; and if upon the trial it shall be determined that such tax or any part thereof was levied or assessed for an illegal or unauthorized purpose, or was for any reason invalid or excessive, judgment shall be rendered therefor, with interest, and the same shall be collected as in other cases. The amount of State taxes for which judgment shall be rendered in such action shall be refunded by the state treasurer."

In *Sherrod v. Dawson*, 154 N. C., 525-529, the Court had before it the question of the proper remedy in a contest over the validity of a tax alleged to be illegal, and on pages 528-529 said:

"An injunction will lie to restrain the collection of taxes and to restrain the sale of property under distraint, for three reasons, to-wit: (1) If the taxes or any part thereof be assessed for an illegal or unauthorized purpose. (2) If the tax itself be illegal or invalid. (3) If the assessment of the tax be illegal or invalid. Revisal, sections 821 and 2855. *Purnell v. Page*, 133 N. C., 125.

"In the case of *Lumber Co. v. Smith*, 146 N. C., 199, which was an action brought to collect taxes on solvent credits, Justice Connor, writing the opinion of the court for an undivided bench, held that injunction is the proper remedy as against delinquent taxes illegally sought to be collected. Upon the same point see, also, *Armstrong v. Stedman*, 130 N. C., 217; *Ins. Co. v. Stedman*, 130 N. C., 221.

"In this case the injunctive relief sought is not merely ancillary to the principal relief demanded in the action, but is itself a main relief, for, assuredly, as to one or the other county, the tax is illegal and invalid.

"In the case of *Hyatt v. DeHart*, 140 N. C., 270, this Court held that it is the general rule that the Court will not dissolve an injunction where the main relief demanded in the action is injunctive.

"In *Purnell v. Page*, 133 N. C., 129, the present Chief Justice spoke for the Court in these words: 'As to the other point, whether the plaintiff can maintain an injunction against the sale of his property under an illegal tax, or must pay the tax under protest and sue to recover it back, it is equally well settled that he can pursue either remedy. *Range Co., v. Carver*, 118 N. C., 331; *Armstrong v. Stedman*, 130 N. C., 217; *Brinkley v. Smith*, 130 N. C., 224, hold that under the language of the statute injunctive relief may be invoked by a tax payer when the tax is invalid or illegal.'"

AN ENLARGEMENT OF EQUITABLE RIGHTS
ARISING FROM THE STATUTES OF A STATE MAY
BE ADMINISTERED BY THE UNITED STATES
COURTS.

In *Smyth v. Ames*, 169 U. S., 466, 516, 517, the Court says:

"One who is entitled to sue in the Federal Circuit Court may invoke its jurisdiction in equity whenever the established principles and rules of equity permit such a suit in that Court; and he cannot be deprived of that right by reason of his being allowed to sue at law in a State Court on the same cause of action. It is true that an enlargement of equitable rights arising from the statutes of a state may be administered by the Circuit Courts of the United States. Case of *Frederick's Will*, 88 U. S., 503, 520; *Holland v. Challen*, 110 U. S., 15-24; *Dick v. Foraker*, 155 U. S., 404; *Borden v. Land & River Improvement Co.*, 157 U. S., 327, 330; *Rich v. Braxton*, 158 U. S., 375, 405. But if the case in its essence be one cognizable in equity, the plaintiff—the required value being in dispute—may invoke the equity powers of the proper Circuit Court of the United States whenever jurisdiction attaches by reason of diverse citizenship, or upon any other ground of Federal jurisdiction. *Payne v. Hook*, 74 U. S., 425, 430; *Mc-*

Conshay v. Wright, 121 U. S., 201, 205. A party, by going into a national court, does not, this Court has said, lose any right or appropriate remedy of which he might have availed himself in the State courts, in the same locality; that the wise policy of the Constitution gives him a choice of tribunals. *Davis v. Gary*, 83 U. S., 203, 221; *Crowley v. Northern Pacific Railroad Co.*, 159 U. S., 569, 583. So wherever a citizen of a state can go into the courts of a state to defend his property against the illegal acts of its officers, a citizen of another state may invoke the jurisdiction of the federal courts to maintain a like defense. A state cannot tie up a citizen of another state, having property rights within its territory, invaded by unauthorized acts of its own officers, to suits for redress in its own courts. *Reagan v. Farmers Loan & Trust Co.* (No. 1), 154 U. S., 362, 291; *Mississippi Mills v. Cohn*, 150 U. S., 202, 204; *Cowles v. Mercer County*, 74 U. S., 118; *Lincoln County v. Luning*, 133 U. S., 529; *Scott v. Neeley*, 140 U. S., 106; *Chicot County v. Sherwood*, 148 U. S., 529; *Cates v. Allen*, 149 U. S., 451."

Under the statutes of the State, as the Supreme Court of the State says, it is well settled that where a tax is attacked as being illegal, it need not be paid and suit brought for its recovery back, but its collection may be enjoined.

It is equally as well settled that plaintiff, a non-resident, may pursue in the federal courts the same remedies he could in the state courts.

The property of complainant may be sold if the tax be not paid within sixty days from the date it becomes due, see Sec. 504. (Appendix, page--).

The Supreme Court of the State reviewed this statute as to the power to tax the salary of judges, in *Long v. Watts* (N. C.), 110 S. E., 765.

REMOVAL OF A CLOUD FROM THE TITLE TO PROPERTY IS A WELL RECOGNIZED RULE OF EQUITABLE JURISDICTION.

In *Shaffer v. Carter*, 252 U. S., 37-51, a suit to enjoin the collection of a state income tax upon the ground that it was illegal, the court considering the question of jurisdiction of the Federal Court, where the state statute gave the tax payer a right to appeal from the decision of the commissioner of revenue, and have all matter complained of reviewed and adjusted to the extent that justice might demand, the Court, on page 48, says:

"The procedure prescribed by paragraph 11 of the Income Tax Law for enforcing such a tax by imposing a lien upon the tax payer's entire property, as threatened to be put into effect against plaintiff's property, for taxes not assessed against the property itself, and not confined to the income that proceeded from the same property, is not 'due process of law,' within the requirements of the Fourteenth Amendment. For removal of a cloud upon title caused by an invalid lien imposed for a tax valid in itself, there appears to be no legal remedy. Hence, on this ground at least, resort was properly had to equity for relief; and since a court of equity does not 'do justice by halves,' and will prevent, if possible, a multiplicity of suits, the jurisdiction extends to the disposition of all questions raised by the bill. *Camp v. Boyd*, 229 U. S., 530, 551, 552; *McGowan v. Parish*, 237 U. S., 285, 296."

Wherefore, we respectfully submit that the Court has jurisdiction of all matters which may arise during the controversy.

PART II ANALYSIS OF STATUTE

The statute, as amended and in force, is set out in full as Appendix B.

Sections 200, 201 and 202 classify tax payers, prescribe the

rate of taxation, the method of apportioning the "net income" of individuals and corporations, between states, where the income is derived from a business done in more than one state.

No contention is made that the method of apportioning the "net income" derived from business conducted in two or more states is illegal, as in that respect, especially as to industrial corporations, the statute follows the rule approved in *Underwood Typewriter Company v. Chamberlain*, 254 U. S., 113.

Sections 200 and 201 prescribe the rate of taxation applicable to individuals and corporations. Sections 201 and 202 classify corporations, while sections 202 and 300 to 307 define what constitutes "net income," of the different classes, which is the subject of taxation under the act.

Section 202 "RAILROADS AND PUBLIC SERVICE CORPORATIONS:

"The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, when such company is required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission, shall be the 'net operating income' of such corporations as shown by their records kept in accordance with that standard classification of accounts, when their business is wholly within this State, and when their business is in part within and in part without the State, their net income within this State shall be ascertained by taking their gross 'operating revenues' within this State, including in their gross 'operating revenues' within this State the equal mileage proportion within this State of their interstate business and deducting from their gross 'operating revenues' the proportionate average of 'operating expenses,' or 'operating ratio,' for their whole business, as shown by the Interstate Commerce Commission Standard Classification of Accounts. From the net operating income thus ascertained shall be deducted 'uncollectable revenue' and

taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this act."

This section defines :

- (a) To what class of corporations it is applicable.
- (b) What shall constitute their "net income" subject to taxation, how it is to be ascertained.
- (c) How it is to be apportioned, when the business is carried on in more than one State.

A. CLASS OF CORPORATIONS, SECTION 202, APPLIES ONLY TO THOSE ENGAGED IN INTER-STATE COMMERCE.

This section is applicable only to those corporations "engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission."

There is no law of the State which requires corporations doing business in the State to keep records in any special manner. The only law requiring corporations to keep records "according to the Standard Classification of Accounting of the Interstate Commerce Commission" is the Act of Congress commonly called the Interstate Commerce Act.

The only corporations subject to the provisions of the Interstate Commerce Act are those engaged as common carriers in interstate or foreign commerce of:—

(a) The transportation of passengers or property wholly by railroad, or partly by railroad and partly by water, when both are used under a common control, management, or arrangement for a continuous carriage or shipment; and,

(b) The transportation of oil or other commodity, except water, and except natural or artificial gas, by pipe line, or partly by pipe line and partly by railroad or water; and,

(c) The transportation of intelligence by wire or wireless.

The act expressly states that it does not apply to corporations engaged in intrastate commerce alone.

Interstate Commerce Act, Sec. 1 (1).

The decisions of the courts are to the same effect.

State of Texas v. Eastern Texas R. R. Co. (U. S. S. Ct. decided March 13, 1922.)

Village of Hubbard, Ohio, v. U. S., 278 Fed., 254.

The basis of the classification, therefore, is:

(1) Corporations engaged as common carriers in foreign or interstate commerce by railroad, pipe line of certain commodities, and the transmission of intelligence by wire or wireless.

(2) All other corporations and tax payers.

Under the laws of North Carolina, corporations owning lines of railroad used chiefly or largely in hauling logs and other commodities, the property of the corporation, upon application to the State Corporation Commission, may obtain a permit to become common carriers, and may limit the character of service to be performed.

Consolidated Statutes, Sec. 3413.

It is not denied that there are in the State a number of corporations which own railroads of standard gauge, operated by steam, which have applied for and obtained authority to act as limited common carriers; that these corporations have filed tariffs of charges with the State Corporation Commission as required by law; that they are supervised by the State Corporation Commission to prevent discrimination. That these corporations are to be governed by the same rules in relation to the public and their employees as steam railroads engaged as common carriers generally, is well settled.

Stewart vs. Railroad, 146 N. C., 47, 49.

Bird v. Leather Co., 143 N. C., 283.

Hemphill v. Lumber Company, 141 N. C., 487.

Wright v. Railroad, 151 N. C., 529.

Blackburn v. Lumber Co., 152 N. C., 361.

It is not denied that these limited common carriers, although engaged in operating standard gauged railroads, have not filed tariffs with the Interstate Commerce Commission, and are not engaged in interstate or foreign commerce, and are not required to keep records according to the Standard Classification of Accounting prescribed by the Interstate Commerce Commission.

The classification, then, for the purpose of defining what constitutes "net income" subject to taxation under the act, is:

(1) Common carriers by railroad, by pipe line of certain classes of commodities, and of transmission of intelligence, when engaged in interstate or foreign commerce.

(2) Common carriers by railroad, by pipe line, and of intelligence, when engaged in intrastate commerce, and all other corporations and individuals.

So that the basis of classification is not the fact of being a railroad or other public service corporation, but whether the business is interstate or foreign commerce or intrastate commerce.

B. DEFINITION OF WHAT CONSTITUTES NET INCOME SUBJECT TO TAXATION, OF THE TWO CLASSES.

(1) THOSE ENGAGED IN INTERSTATE OR FOREIGN COMMERCE BY RAILROAD, PIPE LINE OR THE TRANSMISSION OF INTELLIGENCE.

This class is controlled by Sec. 202, which says the "net income" subject to taxation shall be the "net operating income" of such corporations as shown by their records kept in accordance with that standard of classification of accounts, when their business is wholly within the State, and when their business is part within and part without the State, their net income within this State shall be ascertained by taking their gross

"operating revenues" within this State, including in their gross "operating revenues" within this State the equal mileage proportion within the State of their interstate business, and deducting from their gross "operating revenue" the proportionate average of "operating expenses" or "operating ratio" for their whole business, as shown by the Interstate Commerce Commission Standard Classification of Accounting. From the net operating income thus ascertained shall be deducted "uncollectible revenue" and taxes paid in this State for the income year, other than income and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this act.

By Chapter 35 of the Public Laws, 1921 (see Appendix B), this was to be increased or decreased by the whole, where the road is situate entirely within the State, and by a mileage proportion where the road is located partly within and partly without the State, of any credit or debit of what is known as the car hire account.

As the statute, in defining what constitutes "net income" subject to taxation for this class of tax payers, refers to operating revenues as shown by records kept according to the rules of the Interstate Commerce Commission, it becomes necessary to examine those rules.

The rules of the Interstate Commerce Commission providing how records of common carriers by railroad, subject to the act, shall be kept, divides their accounts of revenue and expense into two classes:

- (1) Operating revenues and operating expenses; and,
- (2) Income, profit and loss, and general balance sheet accounts.

As to the first class, "operating revenue" and "operating expenses," which the statute refers to, the orders of the commission, among others, provide:

- (1) "Operating Accounts.—The accounts of this classification are designed to show the revenues and expenses (including the maintenance of the facilities used) of the carrier's railway

operations, including rail-line transportation, water transportation, if any, and services incident to transportation. Transportation includes the receipt, conveyance and delivery of traffic."

(Pr. R., page 53.)

(2) (1) of special instructions.

Accounts for Operating Revenues—"The accounts provided for operating revenues are designed to show the amounts of money which a carrier becomes entitled to receive from transportation and from the operations incident thereto." (Pr. R., page 53.)

(3) Operating Expenses—"The accounts prescribed for operating expenses are designed to show expenses of furnishing transportation services, including the expense of maintaining the plants used in the service." (Pr. R., page 54.)

The rules of the commission further provide:

"Miscellaneous Operations: The revenue and expenses of miscellaneous operations, involving the use of such facilities as hotels and restaurants, power plants, cold storage plants, cotton compresses, wood preserving plants, ice supply plants, etc., shall not be included in the accounts of the classification when the facilities used are distinct from those used by the carrier in the service of transportation or in the maintenance of facilities used in transportation service, and the operations are not incident to such service."

It is manifest, therefore, that under a system of records kept according to the rules and orders of the Interstate Commerce Commission, the terms "operating revenues," "gross operating revenues," "operating income," "expenses" and "net operating revenues" all relate solely to that revenue and expense of the carrier which is derived from and necessary to carry on transportation, and, when limited to common carriers engaged in interstate or foreign commerce, those terms relate to revenues and expenses arising from or made in the carrying

on of interstate commerce, and exclude all other classes of revenue and expenses except those derived from transportation.

The second class of accounts, those designated "income, profit and loss, and general balance sheet accounts," deal with the gross revenues and expenses arising not only from conducting transportation, but from all sources.

As to this class of accounts, the order of the Commission provides:

"Income accounts are those designed to show as nearly as practicable, for each fiscal period, the total amount of money that a carrier becomes entitled to receive for services rendered, the returns accrued upon investments, the accrued costs paid or payable for services rendered by it, the losses sustained by it, the amounts accrued for taxes, for use of money and for the use of properties of others, and the appropriations made from income during the period. The net balance of income (or loss) shall be carried to 'profit and loss.'"

This net balance is the true "net income" of the carriers. It is admitted plaintiff had none for the tax year under consideration.

Under this system of accounting, the term "net operating income" or gross operating income less operating expenses, excludes from gross income all gain from:

- (a) Rents of facilities owned by this company and used jointly with it by another or other carriers.
- (b) Rent from property not used for common carrier purposes.
- (c) Receipts from the use of non-operating physical property.
- (d) Interest upon bonds and dividends upon stocks owned.
- (e) Gain or profits from the sale or conversion of capital assets.

There is also excluded all rents paid for property used in the business and necessary for the continuation of the business, where no title is taken thereto; interest paid, whether on funded

or unfunded debts; discounts or amortization of debts, and any and all other losses and expenses, unless arising out of the carrying on of transportation.

Of course, car hire is excepted, as that is taken from the income account and charged or allowed as it is a credit or a debit balance.

If income be as defined in *Eisner v. McComber*, 252 U. S., 189, 207, "The gain derived from capital, from labor or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets," it is manifest that the statute was not designed to, and does not, deal with or tax plaintiff's income, but only undertakes to tax that portion of its revenues derived from the transportation of passengers and property in interstate, foreign and intrastate commerce, less certain items of expense.

If the term "net income" be the same as "net earnings," and it be given the definition given the latter term in *St. John v. Erie Railway Company*, 98 U. S., 136, 147, 148, where Mr. Justice Sawyer, for the Court, says: "The preferred dividends were to be paid out of the 'net earning of the road.' The lexical definition of 'net' is 'clear of all charges and deductions,' Webster; 'that which remains after deductions of all charges or outlays, as net profits,' Worcester. The popular acceptance of the term is the same."

It is clear that the tax is not laid upon the "net income" of the plaintiff, and does not deal with its income, but only revenue and expenses from transportation; so that plaintiff and others in its class are taxed not upon income or net income, but upon revenues from transportation, less certain items of expense allowed as deductions.

(2) THOSE COMMON CARRIERS BY STEAM RAILROAD, BY PIPE LINE AND IN THE TRANSMISSION OF INTELLIGENCE, ENGAGED SOLELY IN INTRASTATE COMMERCE, TOGETHER WITH ALL OTHER TAX PAYERS.

What constitutes the "net income" subject to taxation of this

class is the difference between their gross income, as set out in Sec. 301, and the deductions authorized by Sec. 306.

"Sec. 301. *Gross Income Defined.* 1. The words 'gross income' include gains, profits and income derived from salaries, wages or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income of the income year in which received by the taxpayer, unless, under the methods of accounting permitted under this act, any such amounts are to be properly accounted for as of a different period.

"2. The words 'gross income' do not include the following items, which shall be exempt from taxation under this act:

"(a) The proceeds of life insurance policies and contracts paid upon the death of the insured to individual beneficiaries or to the estate of the insured.

"(b) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment or annuity contracts, either during the term or at the maturity of the term mentioned in the contract, or upon surrender of the contract.

"(c) The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income).

"(d) Interest upon the obligations of the United States or its possessions, or of the State of North Carolina.

"(e) Salaries, wages or other compensation received from the United States by officials or employees thereof,

including persons in the military or naval forces of the United States.

"(f) Any amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received, whether by suit or agreement, on account of such injuries or sickness."

This section is longer than the definition of income by this Court in *Eisner v. McCumber*, *supra*, but both cover the same ground, with the difference the statute excepts gain from sources which the State may not tax, i.e., salaries and interest paid by United States Government, and also interest on its own bonds.

"Sec. 306. *Deductions.* In computing net income, there shall be allowed as deductions:

"(1) All the ordinary and necessary expenses paid during the income year in carrying on any trade or business, including:

"(a) As to individuals, wages of employees for services actually rendered in producing such income.

"(b) As to partnerships, wages of employees and a reasonable allowance for copartners or members of a firm, for services actually rendered in producing such income, the amount of such salary allowance to be included in the personal return of the copartner receiving same.

"(c) As to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income.

"2. Rentals or other payments required to be made as a condition of the continued use or possession, for the purpose of the trade of property to which the tax payer has not taken or is not taking title or in which he has no equity.

"3. All interest paid during the income year on indebtedness, except interest on obligations contracted for

the purchase of non-taxable securities. Dividends on preferred stock shall not be deducted as interest.

"4. Taxes for the income year, except taxes on income and war profits, and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed.

"5. Dividends from stock in any corporation the income of which shall have been assessed and the tax on such income paid by the corporation under the provisions of this act: *Provided*, that when only part of the income of any corporation shall have been assessed under this act, only a corresponding part of the dividends received therefrom shall be deducted.

"6. Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit.

"7. Debts ascertained to be worthless and charged off within the income year, if the amount has previously been included in gross income in a return under this act.

"8. A reasonable allowance for the depreciation and obsolescence of property used in the trade or business; and, in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion: *Provided*, that in computing the deductions allowed under this paragraph, the basis shall be the cost (including in the case of mines, oil and gas wells, and other natural deposits, the cost of development not otherwise deducted), and in the case of property acquired prior to January 1, 1921, the fair market value of the property (or the tax payer's interest therein) on that date shall be taken in lieu of cost up to that date. The reasonable allowances under this paragraph shall be made under rules and regulations to be prescribed by the Tax Commission. In the case of leases, the deductions allowed may be equitably apportioned between the lessor and lessee.

"9. In the case of tax payers who keep regular books of

account, upon an accrual basis and in accordance with standard accounting practice, reserves for bad debts and for contingent liabilities, under such rules and restrictions as the Tax Commission may impose. If the Tax Commission shall at any time deem the reserve excessive in amount, it may restore such excess to income, either in a subsequent year or as a part of the income of the income year, and assess it accordingly.

"10. Contributions or gifts made within the taxable year, to corporations or associations operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the tax payer's net income as computed without the benefit of this subdivision.

"11. Resident individuals having an established business in another State, or investment in property in another State, may deduct the net income from such business or investment if such business or investment is in a State that levies a tax upon such net income. The deduction authorized in this sub-section shall in no case extend to any part of income of resident individuals from personal services, or mortgages, stocks, bonds, securities and deposits.

"12. In the case of nonresident individuals, the deductions allowed in this section shall be allowed only if, and to the extent that, they are connected with income arising from sources within the State; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the State shall be determined under rules and regulations prescribed by the State Tax Commission."

These deductions cover all expenses and losses of a corporation, so that what is left is that which Mr. Justice Van Deventer, in *William E. Peck & Co. v. Lowe*, 247 U. S., 165, said as

to the revenue derived from exportation of goods, could be taxed as "net income," viz: what is left "after all expenses are paid and losses adjusted, and after the recipient of the income is free to use it as he chooses."

This constitutes true "net income," and admittedly is the subject of taxation. Plaintiff admittedly has none.

Plaintiff, under the statute, is not required to report, as part of its income, money derived:

(1) From any business it may conduct except the business of transportation and its incidents;

(2) From any property which it may own, either by way of rents (except cars) or interest upon money loaned, or dividends upon stocks owned, or by sale or conversion of capital assets;

All of which are included in the definition of gross income of all other tax payers, including railroads engaged solely in intrastate commerce.

Plaintiff, under this statute, is not allowed to deduct from its gross income:

(1) Rent paid for the use of property used in its business (except car hire) and necessary to the continued carrying on of the business, and where plaintiff has not taken title, nor is taking title and has no equity in the property.

(2) The cost of conducting and carrying on any business other than that of transportation and its incidents.

(3) Interest paid for the use of money, whether funded or short term loans, irrespective of why it became necessary to incur this expense.

(4) Losses from storm, fire or otherwise, not covered by insurance, unless it be such as can be charged to the cost of conducting transportation.

All other tax payers, including those operating steam railroads in intrastate commerce, are allowed to deduct these expenses from their gross income, in order to ascertain the "net income" subject to taxation.

PART III.

THE STATUTE CONTRAVENES ARTICLE I, SEC. 8,
OF THE CONSTITUTION OF THE UNITED STATES.
(The Commerce Clause). 74

Mr. Chief Justice Fuller, speaking for the Court, in *Postal Telegraph & Cable Company v. Adams*, 155 U. S., 688, 696, says:

"It is settled that where by way of duties laid on the transportation of the subjects of interstate commerce, *or on the receipts derived therefrom*, or on the occupation or business of carrying it on, a tax is levied on interstate commerce, such a taxation amounts to a regulation of commerce and cannot be sustained." (Italics supplied).

This is cited with approval in *Crew Lerick Co. v. Pennsylvania*, 245 U. S., 292, 294, where Mr. Justice Pitney also says, we:

"Are in duty bound to determine the question raised under the Federal Constitution, upon our own judgment of the actual operation and effect of the tax, irrespective of the form it bears."

In *Galveston, H. & S. A. R. Co. v. Texas*, 210 U. S., 217, 227, Mr. Justice Holmes, for the Court, says:

"Neither the State courts, nor the Legislature, by giving the tax a particular name, or by the use of some form of words, can take away our duty to consider its nature and effect."

We have already pointed out in an analysis of the statute that the tax in question is not a tax upon plaintiff's "net income" but on the contrary is a tax upon that part of its revenue derived from transportation of passengers and commodities in foreign, interstate and intrastate commerce, after deducting therefrom the cost of conducting that transportation, uncol-

lectible railway revenue, taxes, the balance being increased or decreased as the rent of cars shows a credit or debit balance.

In *Peck Co. v. Lowe*, 247 U. S., 165, where the Court had under consideration the income tax act of the United States, which was attacked upon the ground that it was a tax upon exports from one State to another, Mr. Justice Van Devanter, for the Court said:

"The tax in question is unlike any of those heretofore condemned. It is not laid on articles in course of exportation, or on anything which inherently or by the usages of commerce is embraced in exportation or any of its processes. On the contrary it is an income tax laid generally on net incomes. And while it cannot be applied to any income which Congress has no power to tax (see *Stanton v. Baltic Mining Co.*, 240 U. S., 554) it is both nominally and actually a general tax. *It is not laid on income from exportation because of its source, or in a discriminative way, but just as it is laid on other income.* The words of the act are 'Net Income arising or accruing from all sources.' There is no discrimination. At most exportation is affected only indirectly and remotely. *The tax is levied after exportation is completed, after all expenses are paid and losses adjusted and after the recipient of the income is free to use it as he chooses.*" (Italics supplied).

The tax under attack does not come within the rule here laid down.

The tax is here laid upon the operating revenues or income of plaintiff, which are derived in part from interstate commerce. Only those corporations engaged in transportation of interstate commerce are taxed in the same way.

The tax must be paid, upon that part of plaintiff's revenue derived from interstate and intrastate commerce, which plaintiff must expend in order to continue to keep possession of those facilities which it is necessary for plaintiff to use in order to continue to carry on its business, i.e., rent of other lines of

railroad, and the joint use of the tracks and facilities of other carriers, which for the tax year 1921 as to plaintiff amounted to \$194,739.55. (See Pr. R., page 20).

The tax must be paid from revenue derived from interstate and intrastate commerce, before plaintiff can use any part of such revenue to pay interest on money borrowed to enable it to either provide the necessary facilities to carry on the business or if necessary to pay the men employed to conduct the business.

Corporations not engaged in interstate commerce, as common carriers, are not so taxed, common carriers by railroad engaged in intrastate commerce within the State, are under the statute taxed in a different manner; true they have been allowed to limit their obligations to the public, but as to those commodities which they hold themselves out as carrying their obligation and duties to the public are necessarily the same as those of the plaintiff, they are both railroad companies and both common carriers.

In what way could the Legislature more clearly indicate its will to tax plaintiff on account of or because it was engaged in interstate commerce, or because of the source from which the revenue taxed is derived.

It selects those corporations which are engaged as common carriers in interstate commerce, and taxes them upon the revenue derived from transportation, less certain deductions; it taxes all other corporations, including those engaged as common carriers by railroad in intrastate commerce in an entirely different manner to the great disadvantage of the first class.

The principle involved was discussed by Mr. Justice Brandies, who, speaking for the Court in *United States Glue Co. v. Oak Creek*, 247 U. S., 321, 328, 329, said:

"A tax upon gross receipts affects each transaction in proportion to its magnitude, and irrespective of whether it is profitable or otherwise. Conceivably it may be sufficient to make the difference between profits and loss, or so to diminish the profits as to impede or discourage the conduct of commerce. A tax upon the net profits has not

the same deterrent effect, *since it does not arise at all unless a gain is shown over and above expenses and losses*, and the tax cannot be heavy unless the PROFITS ARE LARGE. Such a tax, when imposed upon *net income from whatever source arising is but a method of distributing the cost of government, like a tax upon property or upon franchise treated as property; and if there be no discrimination against interstate commerce, either in the admeasurement of the tax or in the means adopted for enforcing it*, it constitutes one of the ordinary and general burdens of government, from which persons and corporations otherwise subject to the jurisdiction of the states are not exempted by the Federal Constitution because they happen to be engaged in commerce among the states." (Italics supplied).

In the case at bar, it is admitted that for the tax year under consideration, plaintiff, after paying rent for hired property used in the conduct of transportation in interstate commerce, and interest, had nothing left from its entire receipts or gross income for that year. Yet the State calls upon plaintiff to pay an income tax of over \$18,000.00.

The admeasurement of the tax consists of applying the rate of taxation to the basis of taxation. When all corporations other than those engaged in interstate commerce as common carriers are allowed to deduct rent of facilities used in the business—and interest paid, from their gross income, and this privilege is not allowed common carriers by railroad engaged in interstate commerce, the rate of taxation being the same, there is necessarily a discrimination in the admeasurement of the tax, to the disadvantage of the interstate carriers.

In *United States Glue Company, supra*, Mr. Justice Brandies, referring to the cases of *Crew Levick Co. v. Pennsylvania*, 245 U. S., 292, and *Peck Co. v. Lowe*, 247 U. S., 165, says:

"The correct line of distinction is so well illustrated in two cases decided at the present term that we hardly need

go further. In *Crew Levick Co. v. Pennsylvania*, 245 U. S., 292, we held that a state tax upon the business of selling goods in foreign commerce, measured by a certain percentage of the gross transactions in such commerce, was by its necessary effect a tax upon the commerce, and at the same time a duty upon exports, contrary to paragraphs 8 and 10 of Article 1 of the Constitution, since it operated to lay a direct burden upon every transaction by withholding for the use of the State a part of every dollar received. On the other hand, in *Peck & Co. v. Lowe*, 247 U. S., 165, we held that the income tax of October 3, 1913, chap. 16, paragraph II, Stat. at L. 166, 172, when carried into effect by imposing an assessment upon the entire net income of a corporation, approximately three-fourths of which was derived from the export of goods to foreign countries, did not amount to laying a tax or duty on articles exported within the meaning of Art. 1, sec. 9, cl. 5 of the Constitution. The distinction between a direct and an indirect burden by way of tax or duty was developed, and it was shown that an income tax laid generally on net incomes, *not on income from exportation because of its source, or in the way of discrimination, but just as it was laid on other income, and affecting only the net receipts from exportation after all expenses were paid and losses adjusted and the recipient of the income was free to use it as he chose, was only an indirect burden.*" (Italics supplied).

The case at bar comes within the same class as the *Crew Levick Co. case*; it is true that the tax under consideration is not one laid upon the gross receipts from transportation; neither is it laid upon the "net income" for "income" does not enter into the tax, only revenue from transportation.

On the other hand, it is true that the tax is not upon the net income after all losses and expenses are paid and the recipient is free to use the balance as he chooses.

Until the recipient pays his rent and interest he is not free to use his income as he chooses.

The tax, therefore, is one upon the receipt from interstate commerce, as such, and therefore void, unless the court is of opinion that the State has the power to tax gross receipts from interstate transportation as such except that part thereof necessary to be used in paying the cost of conducting such transportation.

True the present statute allows a deduction of car hire debit balance, if any exists, but if the power exists to exclude the rent of a track for the car to run over, the same legal principles gives the right to exclude the rent of a car to haul the commodities.

If the power exists to exclude rent of facilities the same legal principles sustain the power to exclude taxes.

If a corporation, in order to do interstate commerce has to hire a track to operate on, a car to operate with, pay taxes thereon as property—and pay interest on money borrowed to pay employees, these constitute a part of the expense of conducting the business, but they do not under the rules of the Interstate Commerce Commission constitute a part of the cost of conducting transportation.

They are all under the rules of the Interstate Commerce Commission excluded from the costs of conducting transportation, they come under the head of income accounts, and constitute a part of the expense of doing business, if one can be excluded in order to ascertain "net income" all can be excluded.

The Interstate Commerce Act, requires transportation to be conducted efficiently and economically, in order that the Commission may consider that duty, a system of accounting is required to show in detail the cost of the various services necessary to perform the act of transportation and its incidents. That part of the accounts does not determine either gross or net income of the carrier.

It is well settled that gross receipts from interstate commerce may not be taxed by a percentage thereof. *United States Glue Company v. Oak Creek Co.*, *supra*, and *Crew Devick Co. v. Pennsylvania*, *supra*, it is settled that the "net income" of a

carrier, although derived from interstate commerce, may be taxed. Is there a line midway between the two where the power of taxation, of receipts, ends? If so, where? We submit that the power ends with the taxation of the "net income."

PART IV.

THE STATUTE CONTRAVENES THE EQUAL PROTECTION CLAUSE OF THE XIV AMENDMENT.

In *Royster Guano Company v. Virginia*, 253 U. S., 412, 415, 420, the Court, through Mr. Justice Pitney, said:

"It is unnecessary to say that the 'equal protection of the laws' required by the Fourteenth Amendment does not prevent the State from resorting to classification for the purpose of legislation. Numerous and familiar decisions of this Court establish that they have a wide range of discretion in that regard. But the classification must be reasonable, not arbitrary and *must rest upon some ground of difference, having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike*. The latitude of discretion is notably wide for the purpose of taxation and the granting of partial or total exemptions upon the grounds of policy. *Bell's Gap R. R. Co. v. Pennsylvania*, 134 U. S., 232, 237; *Michigan R. R. Co. v. Powers*, 201 U. S., 245, 293; *Keeney v. New York*, 222 U. S., 525, 536; *Citizen Telephone Co. v. Fuller*, 229 U. S., 322, 329; *Northwestern Mutual Life Ins. Co. v. Wisconsin*, 247 U. S., 132, 139. Nevertheless, a discriminatory tax law cannot be sustained against the complaints of a party aggrieved, if the classification appears to be altogether illusory." (Italics supplied).

The thing in respect to which the classification in the case at bar is imposed is "net income" for the purpose of taxation.

The classification is made upon the basis of how corporations are required to keep their records.

In the case at bar, it appears that one class of corporations are required by law to keep their records according to certain rules prescribed by the Interstate Commerce Commission, all other corporations are permitted to keep such records as they deem best.

It appears that only those corporations engaged in interstate or foreign commerce, as common carriers by railroad, by pipe line or of intelligence are required to keep them according to the method used by the statutes, as a means of selecting or designating the class to which it is applicable.

Therefore, the real, true classification is:

(a) Those common carriers engaged in interstate commerce by railroad, pipe line or the transmission of intelligence; and,

(b) All other corporations, including common carriers engaged in intrastate commerce alone, by railroad, pipe line and the transmission of intelligence.

The real classification then is based on whether the corporation is or is not engaged as a common carrier in interstate commerce.

The result of the classification is to allow one class of corporations to deduct from their gross income all rents paid for the continued use in the business, and all interest paid and losses incurred, in order to ascertain their "net income"; this privilege is denied to the other class, the class engaged in interstate transportation.

If the basis of classification, to make it legal, must be, as said in the *Royster case*, *supra*, "*That all persons similarly circumstanced shall be treated alike*," then the statute must fall.

Two corporations, one a common carrier engaged in interstate commerce, the other an industrial corporation, both rent a plant, with which to conduct their business, both pay interest, both borrow money to supply additional facilities, or to pay employees, both pay interest on funded and unfunded debt; the industrial corporation is allowed to deduct from its gross income the rent and interest paid before taxation as net, the other is refused this privilege.

Both are similarly circumstanced as to the payment of rent and interest, it is true that their gross income comes from different occupations, but that does not affect the question of what constitutes "net income," and if it should be held to be affected by the source from which the gross comes, i.e., Interstate Commerce, then it would be a tax upon that business and as such in contravention of the United States Constitution.

The affidavit of A. J. Maxwell (Pr. R., page 30, 31), gives the reason that prompted the Legislature to adopt the classification that it did.

(1) For excluding from deductions allowed to *Interstate Common Carriers* by railroad, rental of leased roads and track-age rights.

That these leases are usually for a long term and with numerous collateral obligations.

(2) That as to interest on bonded debts, that railroads are financed by bond issues.

(3) That if these items of expense are allowed as deductions to the plaintiffs "THE RESULT WOULD BE THAT THEY WOULD HAVE NO INCOMES SUBJECT TO TAX UNTIL THEY HAD EARNED ENOUGH TO PROVIDE NOT ONLY FOR ALL BUSINESS AND OPERATING EXPENSES, BUT ALSO FOR ALL CAPITAL EXPENSES AND HAD PAID ALL INTEREST ON THEIR BONDS. IN OTHER WORDS, IT WOULD AMOUNT TO NOTHING MORE THAN A TAX UPON SAVINGS OF RAILROADS."

United States Glue Company v. Oak Creek, supra, and *Crew Levick v. Pennsylvania, supra*, *Peck Co. v. Lowe, supra*, all say that the savings of a taxpayer, that which is left of his income, that he may use as he chooses, is what may be taxed as "net income," even though derived from interstate commerce.

The affidavit filed by the State, shows conclusively that the Legislature drew a bill which taxed and was intended to tax more than this "net income."

This money paid by plaintiff for leased roads is subject

to income taxes in the hands of the lessor, and a tax is paid thereon to the State of North Carolina, as both lessors are North Carolina corporations, not engaged in interstate commerce. The interest paid on plaintiff's bonds, if held in North Carolina, is subject to income taxation in the hands of the holder.

True, Mr. Maxwell, in his affidavit, says all railroads are in one class, but the evidence does not bear him out. The words of the statutes are different, and the statute controls.

State v. Green, 126 N. C., 1032.

Attorney General v. Bank, 57 N. C., 287.

42 Broadway v. Anderson, 209 Fed., 991, 993.

PART V.

THE STATUTE CONTRAVENES THE UNIFORMITY CLAUSE OF THE STATE CONSTITUTION.

The Constitution of the State, Article V, Sec. 3, provides:

"Taxation shall be by uniform rule and ad valorem: Exemptions. Laws shall be passed taxing, by a uniform rule, all moneys, credits, investments in bonds, stocks, joint-stock companies, or otherwise; and, also, all real and personal property, according to its true value in money: *Provided*, notes, mortgages, and all other evidence of indebtedness given in good faith for the purchase price of a home, when such purchase price does not exceed three thousand dollars, and said notes, mortgages, and other evidence of indebtedness shall be made to run for not less than five nor more than twenty years, shall be exempt from taxation of every kind: *Provided*, that the interest carried by such notes and mortgages shall not exceed five and one-half per cent. The General Assembly may also tax trades, professions, franchises, and income: *Provided*, the rate of tax on incomes shall not in any case exceed six per cent (6%), and there shall be allowed the following exemptions, to be deducted from the amount of annual incomes, to-wit: for a married man with a wife living with him, or to a widow

or widower having minor child or children, natural or adopted, not less than \$2,000; to all other persons not less than \$1,000, and there may be allowed other deductions (not including living expenses) so that only net incomes are taxed."

Under the construction put upon this section of the Constitution by the highest Court of the State, all taxes upon trades, professions and incomes must be uniform as to all persons belonging to the same class.

Smith v. Wilkins, 164 N. C., 135, 143.

Gatlin v. Tarboro, 78 N. C., 119, 132.

Lacy v. Packing Co., 134 N. C., 567, 571.

State v. Williams, 158 N. C., 610, 613.

Where the Court says:

"Constitutional and legislative authority conferred upon a municipality to tax does not enable it to create a privilege for the purpose of taxing it, or to discriminate between persons exercising the same privilege by imposing a tax upon one of a class at a higher rate, in a different mode or upon other principles than one applied to the exercise of the same privilege of the same class."

The affidavits of F. C. Harding, A. R. Turnbull, Nathan O'Berry and O. S. Thompson show that there are a number of railroads in the State, which act as common carriers. True, their principal business is hauling logs for their owners; true, they only haul a limited class of commodities; true, they do not run regular schedules; true, that their common carrier business is light, and they may operate at a loss. (So did the plaintiff, after paying rent and interest during the tax year under consideration.) True, the Corporation Commission says it does not treat them in the same way or same class as the larger roads; true, the Commissioner of Revenue says he construes Section 202 as applying to them, but they do not agree to this construction of the law, and do not come within the terms of the statute.

If these limited common carriers by steam railroad are not treated by the Corporation Commission as other common carriers by steam railroad are treated, it shows that the Commission does not follow the Supreme Court of the State.

Stewart v. Lumber Co., 146 N. C., 47, 49.

They are all in the same class as to what constitutes "net income."

The statute denies equal treatment to all of those in the same class.

A corporation doing a large business at a loss is in the same class as a corporation doing a small business of the same kind at a loss, so far as "net income" is concerned. If the corporation doing a small business does it at a profit that puts it in a better class than if it did a large business at a loss.

Wherefore, it is respectfully submitted that the statute and the tax assessed and sought to be collected are illegal and void, as being in contravention of the Constitution of the United States, Article 1, Sec. 8 (Commerce Clause), for that:

(1) It is a tax, not upon plaintiff's net income, but upon plaintiff's revenues derived from interstate and foreign commerce, and as such bears directly upon and burdens interstate commerce.

(2) That the tax is laid, not upon plaintiff's "net income," but upon plaintiff by reason of the fact that it is engaged in interstate commerce, and in a discriminatory manner, as to mode and admeasurement.

(3) It is in violation of the XIV Amendment because it selects plaintiff and others similarly situated, based upon the sole fact that plaintiff is engaged in interstate commerce and is therefore void.

(4) That it contravenes the uniformity clause of the State Constitution.

W. B. RODMAN,
C. M. BAIN,
For Plaintiff.

APPENDIX "A"

In the District Court of the United States for the Eastern District of North Carolina.

(Title of Cause.)

ASSIGNMENT OF ERRORS

The plaintiff prays an appeal from the final decree of this Court, to the Supreme Court of the United States, and assigns for error:

(1) That Schedule "D" of the said Act of the General Assembly of the State of North Carolina, Chapter 34 Public Laws of 1921, being an act entitled "An Act to Raise Revenue," ratified the 8th day of March, 1921, and the amendments and supplements thereto, and especially the said act as amended by Chapter 102 of the Public Laws of the Extra Session, 1921, ratified the 19th day of December, 1921, and entitled "An Act to Amend Chapter 34 of the Public Laws of 1921, being an Act to Raise Revenue, relative to privilege tax and the Income Tax on Railroads," is in contravention of the Constitution of the United States, especially of the interstate commerce laws, section 8, article 1; of section 2, article 4; of section 1, article 14.

(2) That the said Act is in contravention of the Constitution of the State of North Carolina, especially of section 3, article 5.

(3) That said Act does not provide a method for the taxation of income of the complainant as required by the Constitution of the State, or by uniform rule as compared with the income of other citizens, residents, persons or corporations doing business in the State of North Carolina, and subject to an income tax, but is really an attempt to enforce against Norfolk Southern Railroad Company and other interstate carriers in the State of North Carolina and of the United States, engaged in interstate commerce, the payment of a tax on account of and for the reason that this plaintiff, and other companies

similarly situated, are engaged in the business of conducting and carrying on interstate commerce by attempting through an unjust, unreasonable and illegal classification to require plaintiff and other railroad companies doing business in the State of North Carolina and engaged in interstate commerce, to pay an income tax upon more than their net income, while all other tax payers are taxed upon their net income.

(4) That the assessment for income tax made by the defendant, A. D. Watts, as Commissioner of Revenue, against the plaintiff was not made upon the net income of this plaintiff, but was made upon what was termed its "net operating income," while all other individuals and corporations doing business in the State of North Carolina and subject to income tax had their income tax assessed upon the basis of their net income, except corporations engaged in the business of operating steam or electric railroads, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission.

That the said assessment of the income tax made by the defendant, A. D. Watts, as Commissioner of Revenue of North Carolina, was illegal and void, as being made upon a classification of plaintiff and other public service corporations engaged in interstate commerce and required to report to the Interstate Commerce Commission, and to keep their records in accordance with the orders of that Commission, and thereby imposed, or undertook to impose a tax upon the plaintiff by reason of the fact that it was engaged in interstate commerce, which tax is greater than would be imposed upon plaintiff if it were not engaged in such interstate commerce, and undertook to classify, for the purpose of an income tax and of ascertaining what constituted net income, taxpayers into two classes, to-wit: Those engaged in interstate commerce in the operation of public service, as common carriers, and all other taxpayers in the other class. That such classification was and is in violation and contravention of the Constitution of the United States,

especially of the interstate commerce clause of section 8, article 1; of section 2, article 4, and of section 1, article 14, and is in violation and in contravention of the Constitution of the State of North Carolina, especially section 3, article 5 thereof.

(5) That the court erred in holding that the United States District Court was without jurisdiction to hear and determine the questions raised by the bill and answer filed in this cause.

(6) That the court erred in holding that the plaintiff was not entitled to have the defendants, or either of them, enjoined or restrained from the performance of the duties imposed upon them by the statutes of North Carolina, relating to the administration, assessing, levying and enforcement of collection of the income tax against plaintiff, and in dismissing the bill.

(7) That the court erred in refusing to enjoin the defendants from undertaking to enforce the collection of the assessment of income tax against the plaintiff, as made by A. D. Watts, Commissioner of Revenue.

W. B. RODMAN,
Attorney for Plaintiff.

APPENDIX "B"

Chapter 34, Public Laws, 1921, as amended by Chapter 102, Public Laws, Extra Session, 1921, and by Chapter 35, Public Laws, 1921.

SCHEDULE D.

INCOME TAX

AN ACT PROVIDING FOR THE LEVYING, COLLECTING, AND PAYING OF AN INCOME TAX ON INDIVIDUALS AND CORPORATIONS.

ARTICLE I

SHORT TITLE AND DEFINITIONS

Sec. 100. *Short Title.* This Act shall be known and may be cited as The Income Tax Act of 1921.

Sec. 101. *Purpose.* The general purpose of this act is to impose a tax, for the use of the State Government, upon the net income for the calendar year 1921, in excess of exemptions herein set out, collectible in the year 1922, and annually thereafter.

- (a) Of every citizen of the State.
- (b) Of every domestic corporation.
- (c) Of every foreign corporation and of every nonresident individual having a business or agency in this State, in proportion to the net income of such business or agency.

Except as otherwise provided in this act the purpose is to conform to the definitions of income in the revenue laws of the United States Government and regulations made under its authority, in so far as they apply.

The tax imposed upon the net income of corporations in this schedule is in addition to the tax imposed under Schedule C of this act.

Sec. 102. *Definitions.* For the purpose of this act and unless otherwise required by the context:

1. The words "Tax Commission" means the State Tax Commission.
2. The word "taxpayer" includes any individual, corporation or fiduciary subject to the tax imposed by this act.
3. The word "individual" means a natural person.
4. The word "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person, whether individual or corporation, acting in any fiduciary capacity for any person, estate or trust.
5. The word "person" includes individuals, fiduciaries, partnerships and corporations.
6. The word "corporation" includes joint-stock companies or associations and insurance companies.
7. The words "domestic corporation" mean any corporation organized under the laws of this State.
8. The words "foreign corporation" mean any corporation other than a domestic corporation.

9. The words "tax year" mean the calendar year in which the tax is payable.

10. The words "income year" mean the calendar year or the fiscal year, upon the basis of which the net income is computed under this act; if no fiscal year has been established they mean the calendar year.

11. The words "fiscal year" mean an income year, ending on the last day of any month other than December.

12. The word "paid" for the purpose of the deductions under this act means "paid or accrued" or "paid or incurred," and the words "paid or accrued," "paid or incurred," and "incurred" shall be construed according to the method of accounting upon the basis of which the net income is computed under this act. The word "received" for the purpose of the computation of the net income under this act means "received or accrued," and the words "received or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this act.

13. The word "resident" applies only to individuals, and includes for the purpose of determining liability to the tax imposed by this act, with reference to the income of any income year, any individual who shall be a resident of the State on the first day of the tax year. In the absence of other satisfactory indicia the residence of a person who has two or more places in which he occasionally dwells may be determined with reference to the place at which the individual lived the longest period of time during the income year.

14. The words "foreign country" mean any jurisdiction other than one embraced within the United States. The words "United States," when used in a geographical sense, include the States, the Territories of Alaska and Hawaii, the District of Columbia, and the possessions of the United States.

ARTICLE II

IMPOSITION OF TAX

Sec. 200. *Individuals.* A tax is hereby imposed upon every

resident of the State, which tax shall be levied, collected and paid annually, with respect to the net income of the taxpayer as herein defined, and upon income earned within this State of every nonresident having a business or agency in the State, computed at the following rates, after deducting the exemptions provided in this act:

On the excess over the amount legally exempted up to twenty-five hundred dollars, one per cent:

On the excess above twenty-five hundred dollars and up to five thousand dollars, one and one-half per cent.

On the excess above five thousand dollars and up to seven thousand, five hundred dollars, two per cent.

On the excess above seven thousand, five hundred dollars and up to ten thousand dollars, two and one-half per cent.

On the excess over ten thousand dollars, three per cent.

Sec. 201. *Corporations.* Every corporation organized under the laws of this State shall pay annually an income tax, equivalent to three per cent of the entire net income of such corporation, as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to three per cent of a proportion of its entire net income, to be determined according to the following rules:

In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale, or rental of real estate or from the manufacture, sale, or use of tangible personal property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State on the date of the close of the fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it, with no deduction on account of incumbrances thereon.

In case of a corporation deriving profits principally from the holding or sale of tangible property, such proportion as its gross receipts in this State for the year ended on the date of the close

of its fiscal year next preceding is to its gross receipts for such year within and without the State.

Sec. 202. *Railroads and public service corporations.* The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, shall be the "net operating income" of such corporation as shown by their records kept in accordance with that standard classification of accounts, when their business is wholly within this State, and when their business is in part within and in part without the State their net income within this State shall be ascertained by taking their gross "operating revenues" within this State, including in their gross "operating revenues" within this State the equal mileage proportion within this State of their interstate business and deducting from their gross "operating revenues" the proportionate average of "operating expenses," or "operating ratio," for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted "uncollectible revenue," and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this act.

Sec. 203. Such tax shall first be levied, collected, and paid in the year 1922, and with respect to the net income received during the calendar year 1921 and annually thereafter.

Sec. 204. *Conditional and other exemptions.* The following organizations shall be exempt from taxation under this act:

(1) Fraternal beneficiary societies, orders or associations, (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and (b) providing for the payment of life, sick, accident

or other benefits to the members of such society, order or association or their dependents.

(2) Building and loan associations and coöperative banks without capital stock, organized and operated for mutual purposes and without profits.

(3) Cemetery corporations and corporations organized for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual.

(4) Business leagues, chambers of commerce, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private stockholder or individual.

(5) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

(6) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private stockholder or member.

(7) Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or coöperative telephone companies or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses.

(8) Farmers, fruit growers', or like organizations, organized and operated as sales agents for the purpose of marketing the products of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them.

Sec. 205. *Fiduciaries.* The tax imposed by this act shall be imposed upon resident fiduciaries, and upon nonresident fiduciaries, having in charge funds or property for the benefit of a resident in this State, which tax shall be levied, collected and paid annually with respect to:

(a) That part of the net income of estates or trusts which has not been distributed or become distributable to beneficiaries during the income year.

(b) The net income received during the income year by deceased individuals who, at the time of death were residents and who have died during the tax year or the income year without having made a return.

(c) The entire net income of resident insolvent or incompetent individuals, whether or not any portion thereof is held for the future use of the beneficiaries, where the fiduciary has complete charge of such net income.

2. The tax imposed upon a fiduciary by this act shall be a charge against the estate or trust.

ARTICLE III

Sec. 300. *Net income defined.* The words "net income" mean the gross income of a taxpayer less the deductions allowed by this act.

Sec. 301. *Gross income defined.* 1. The words "gross income" include gains, profits and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transactions of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income of the income year in which received by the taxpayer, unless, under the methods of accounting permitted under this act, any such amounts are to be properly accounted for as of a different period.

2. The words "gross income" do not include the following items, which shall be exempt from taxation under this act.

(a) The proceeds of life insurance policies and contracts

paid upon the death of the insured to individual beneficiaries or to the estate of the insured.

(b) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

(c) The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income).

(d) Interest upon the obligations of the United States or its possessions, or of the State of North Carolina.

(e) Salaries, wages, or other compensation received from the United States by officials or employees thereof, including persons in the military or naval forces of the United States.

(f) Any amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received, whether by suit or agreement, on account of such injuries or sickness.

Sec. 302. *Basis of return of net income.* 1. Taxpayers who customarily estimate their income on a basis other than that of actual cash receipts and disbursements may, with the approval of the Tax Commission, return their net income under this act upon a similar basis. Taxpayers who customarily estimate their income on the basis of an established fiscal year instead of on that of the calendar year, may, with the approval of the tax Commission, and subject to such rules and regulations as it may establish, return their net income under this act on the basis of such fiscal year, in lieu of that of the calendar year.

2. A taxpayer may, with the approval of the Tax Commission and under such regulations as it may prescribe, change the income year from fiscal year to calendar year or otherwise, in which case his net income shall be computed upon the basis of such new income year.

3. An individual carrying on business in partnership shall be

liable for income tax only in his individual capacity, and shall include in his gross income the distributive share of the net income of the partnership received by him or distributed to him during the income year.

4. Every individual taxable under this act who is a beneficiary of an estate or trust, shall include in his gross income the distributive share of the net income of the estate or trust, received by him or distributable to him during the income year. Unless otherwise provided in the law, the will, the deed, or other instrument creating the estate, trust or fiduciary relation, the net income shall be deemed to be distributed or distributable to the beneficiaries (including the fiduciary as a beneficiary, in the case of income accumulated for future distribution) ratably, in proportion to their respective interests.

Sec. 303. *Determination of gain or loss.* For the purpose of ascertaining the gain or loss from the sale or other disposition of property, real, personal or mixed, the basis shall be, in the case of property acquired before January 1, 1921, the fair market price or value of such property as of that date, if such price or value exceeds the original cost, and in all other cases, the cost thereof: *Provided*, that in the case of property which was included in the last preceding annual inventory used in determining net income in a return under this act, such inventory value shall be taken in lieu of cost or market value. The final distribution to the taxpayer of the assets of a corporation shall be created as a sale of the stock or securities of the corporation owned by him and the gain or loss shall be computed accordingly. If at any time gains and profits realized by sale of property by other than traders in such property at an increase over the purchase price, or an increase over the fair value of the property on January 1, 1921, shall be held by the Supreme Court of the United States not to be taxable income by the United States Government, such decision shall govern the liability of such gains and profits for taxation as income under this act.

Sec. 304. *Exchanges of property.* 1. When property is ex-

changed for other property, the property received in exchange shall, for the purpose of determining gain or loss, be treated as the equivalent of cash to the amount of its fair market value: *Provided*, a market exists in which all the property so received can be disposed of at the time of exchange, for a reasonably certain and definite price in cash; otherwise such exchange shall be considered as a conversion of assets from one form to another, from which no gain or loss shall be deemed to arise.

2. In the case of the organization of a corporation, the stock or securities received shall be considered to take the place of property transferred therefor and no gain or loss shall be deemed to arise therefrom.

3. When, in connection with the reorganization, merger, or consolidation of a corporation, a taxpayer receives, in place of stock or securities owned by him, new stock or securities, the basis of computing the gain or loss if any shall be, in case the stock or securities owned were acquired before January 1, 1921, the fair market price or value thereof as of that date, if such price or value exceeds the original cost, and in all other cases the cost thereof.

Sec. 305. *Inventory.* Whenever in the opinion of the Tax Commission the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer, upon such basis as the Tax Commission may prescribe, conforming as nearly as may be the best accounting practice in the trade or business and most clearly reflecting the income, and conforming so far as may be, to the forms and methods prescribed by the United States Commissioner of Internal Revenue, under the act of Congress then providing for the taxation of income.

Sec. 306. *Deductions.* In computing net income there shall be allowed as deductions:

1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business, including:

(a) As to individuals, wages of employees for services actually rendered in producing such income.

(b) As to partnerships, wages of employees and a reasonable allowance for copartners or members of a firm, for services actually rendered in producing such income, the amount of such salary allowance to be included in the personal return of the copartner receiving same.

(c) As to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income.

2. Rentals or other payments required to be made as a condition of the continued use or possession, for the purposes of the trade of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

3. All interest paid during the income year on indebtedness except interest on obligations contracted for the purchase of nontaxable securities. Dividends on preferred stock shall not be deducted as interest.

4. Taxes for the income year, except taxes on income and war profits, and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed.

5. Dividends from stock in any corporation the income of which shall have been assessed and the tax on such income paid by the corporation under the provisions of this act: *Provided*, that when only part of the income of any corporation shall have been assessed under this act only a corresponding part of the dividends received therefrom shall be deducted.

6. Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit.

7. Debts ascertained to be worthless and charged off within the income year, if the amount has previously been included in gross income in a return under this act.

8. A reasonable allowance for the depreciation and obsolescence of property used in the trade or business; and, in the case of mines, oil, and gas wells, other natural deposits, and timber, a reasonable allowance for depletion: *Provided*, that in

computing the deductions allowed under this paragraph, the basis shall be the cost (including in the case of mines, oil, and gas wells, and other natural deposits, the cost of development, not otherwise deducted), and in the case of property acquired prior to January 1, 1921, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date. The reasonable allowances under this paragraph shall be made under rules and regulations to be prescribed by the Tax Commission. In the case of leases the deductions allowed may be equitably apportioned between the lessor and lessee.

9. In the case of taxpayers who keep regular books of account, upon an accrual basis and in accordance with standard accounting practice, reserves for bad debts and for contingent liabilities, under such rules and restrictions as the Tax Commission may impose. If the Tax Commission shall at any time deem the reserve excessive in amount it may restore such excess to income, either in a subsequent year or as a part of the income of the income year and assess it accordingly.

10. Contributions or gifts made within the taxable year to corporations or associations operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's net income as computed without the benefit of this subdivision.

11. Resident individuals having an established business in another State, or investment in property in another State, may deduct the net income from such business or investment, if such business or investment is in a State that levies a tax upon such net income. The deduction authorized in this subsection shall in no case extend to any part of income of resident individuals from personal services, or mortgages, stocks, bonds, securities and deposits.

12. In the case of a nonresident individual, the deductions

allowed in this section shall be allowed only if, and to the extent that, they are connected with income arising from sources within the State; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the State shall be determined under rules and regulations prescribed by the State Tax Commission.

Sec. 307. *Items not deductible.* In computing net income no deduction shall in any case be allowed in respect of:

(a) Personal, living, or family expenses.

(b) Any amount paid out for new buildings or for permanent improvements or betterments, made to increase the value of any property or estate.

(c) Any amount expended in restoring property for which an allowance is or has been made.

(d) Premiums paid on any life insurance policy.

Sec. 308. *Exemptions.* 1. There shall be deducted from the net income the following exemptions:

(a) In the case of a single individual, a personal exemption of \$1,000.

(b) In the case of a married man with a wife living with him, \$2,000.

(c) In the case of a widow or widower having minor child or children, natural or adopted, \$2,000.

(d) \$200 for each individual (other than husband and wife) dependent upon and receiving his chief support from the taxpayer, if such dependent individual is under eighteen years of age or is incapable of self-support, because mentally or physically defective.

(e) In the case of a fiduciary, if taxable under clause (a) of paragraph 1 of sec. 205, a personal exemption of \$1,000; if taxable under clause (b) of said paragraph, the same exemption as would be allowed the deceased, if living; if taxable under clause (c) of said paragraph the same exemptions to which the beneficiary would be entitled.

2. The exemptions allowed by this section shall not be allowed with respect to a resident of this State having income

from a business or agency in another State, or with respect to a nonresident having a business or agency in this State, unless the entire income of such resident or nonresident individual is shown in the return of such resident or nonresident, and if the entire income is so shown the exemption shall be probated in the proportion of the income in this State to the total income.

3. The status on the last day of the income year shall determine the right to the exemptions provided in this section: *Provided*, that a taxpayer shall be entitled to such exemptions for husband or wife or dependent who has died during the income year.

ARTICLE IV

RETURNS

Sec. 400. *Returns.* 1. Every resident or nonresident having a net income during the income year taxable in this State of \$1,000 and over, if single, or if married and not living with husband or wife; or having a net income for the income year of \$2,000 or over, if married and living with husband or wife; and every corporation having a net income in excess of \$1,000, shall make a return under oath, stating specifically the items of gross income and the deductions and exemptions allowed by this act, and such other facts as the Tax Commission may require for the purpose of making any computation required by this act. When the Tax Commission has reason to believe any person or corporation is liable for tax under this act, it may require any such person or corporation to make a return.

2. If a husband and wife living together have an aggregate net income of \$2,000 or over, each shall make such a return, unless the income of each is included in a single joint return.

3. If the taxpayer is unable to make his own return, the return shall be made by a duly authorized agent or by a guardian or other person charged with the care of the person or property of such taxpayer.

4. The return by a corporation shall be sworn to by the

president, vice president, or other principal officer, and by the treasurer or assistant treasurer.

5. The return of an individual who, while living, received income in excess of the exemption during the income year and who has died before making the return, shall be made in his name and behalf by the administrator or executor of the estate and the tax shall be levied upon and collected from his estate. Before a corporation shall be dissolved and its assets distributed it shall make return for and settlement of tax for any income earned in the tax year up to its period of dissolution.

6. Where the Tax Commission has reason to believe that any taxpayer so conducts the trade or business as either directly or indirectly to distort his true net income and the net income properly attributable to the State, whether by the arbitrary shifting of income, through price fixing, charges for service or otherwise, whereby the net income is arbitrarily assigned to one or another unit in a group of taxpayers carrying on business under a substantially common control, it may require such facts as it deems necessary for the proper computation of the entire net income and the net income properly attributable to the State and in determining the same the Tax Commission shall have regard to the fair profit which would normally arise from the conduct of the trade or business.

Sec. 401. *Fiduciary returns.* 1. Every fiduciary subject to taxation under the provisions of this act as provided in section 205 hereof, shall make a return under oath, for the individual, estate or trust for whom or for which he acts, if the net income thereof amounts to \$1,000 or over.

2. The return made by a fiduciary shall state specifically the items of gross income, and the deductions and exemptions allowed by this act and such other facts as the Tax Commission may prescribe. Under such regulations as the Tax Commission may prescribe a return may be made by one or two or more joint fiduciaries.

3. Fiduciaries required to make returns under this act shall

be subject to all the provisions of this act which apply to individuals.

Sec. 402. *Information at source.* 1. Every individual, partnership, corporation, joint stock company or association or insurance company, being a resident or having a place of business in this State, in whatever capacity acting, including lessee or mortgagors of real or personal property, fiduciaries, employers and all officers and employees of the State or of any political subdivision of the State, having the control, receipt, custody, disposal or payment of interest (other than interest coupons payable to bearer), rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments or other fixed or determinable annual or periodical gains, profits and income, amounting to \$1,000 or over paid, or payable during any year to any taxpayer, shall make complete return thereof to the Tax Commission, under such regulations and in such form and manner and to such extent as may be prescribed by it.

2. Every partnership, having a place of business in the State, shall make a return, stating specifically the items of its gross income and the deductions allowed by this act, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed, and the amount of the distributive share of each individual. The return shall be sworn to by one of the partners.

3. Every fiduciary shall make, under oath, a return for the individual, estate or trust for whom or for which he acts, if the net income thereof, distributed or distributable to beneficiaries during the year is one thousand dollars or over, in which case the fiduciary shall set forth in such return the items of the gross income, the deductions allowed by this act, and the net income, the names and addresses of the beneficiaries, the amounts distributed or distributable to each and the amount, if any, lawfully retained by him for future distribution. Such return may be made by one of two or more joint fiduciaries.

Sec. 403. *Time and place of filing returns.* Returns shall be in such forms as the Tax Commission may from time to

time prescribe and shall be filed with the Tax Commission, at its main office or at any branch office which it may establish, on or before the fifteenth day of March in each year, and for all taxpayers using a fiscal year, within sixty days after expiration of the fiscal year. In case of sickness, absence, or other disability, or whenever in its judgment good cause exists, the Tax Commission may allow further time for filing returns. There shall be annexed to the return the affidavit or affirmation of the taxpayer making the return, to the effect that the statements contained therein are true. The Tax Commission shall cause to be prepared blank forms for the said returns and shall cause them to be distributed throughout the State and to be furnished upon application, but failure to receive or secure the form shall not relieve any taxpayer from the obligation of making any return herein required.

Sec. 404. *Blank forms to be kept on file with Register of Deeds.* For convenience of all parties liable for making a return of income, and who may not receive blank forms by mail for this purpose, the State Tax Commission shall keep on deposit with the Register of Deeds in each county a supply of blank forms for distribution.

Sec. 405. *Failure to file returns; supplementary returns.* If the Tax Commission shall be of the opinion that any taxpayer has failed to file a return, or to include in a return filed, intentionally or through error, items of taxable income, it may require from such taxpayer a return, or a supplementary return, under oath, in such form as it shall prescribe, of all the items of income which the taxpayer received during the year for which the return is made, whether or not taxable under the provisions of this act. If from a supplementary return, or otherwise, the Tax Commission finds that any items of income, taxable under this act, have been omitted from the original return, or any items returned as taxable that are not taxable, or any item of taxable income overstated, it may require the items so omitted to be disclosed to it, under oath of the taxpayer, and to be added to or deducted from the original return. Such

supplementary return and the correction of the original return shall not relieve the taxpayer from any of the penalties to which he may be liable under any provision of this act. The Tax Commission may proceed under the provisions of section 502 of this act, whether or not it requires a return or a supplementary return under this section.

ARTICLE V

COLLECTION AND ENFORCEMENT OF TAX

Sec. 500. *Time and place of payment of tax.* 1. The full amount of the tax payable, as the same shall appear from the face of the return, shall be paid to the Tax Commission at the office where the return is filed at the time fixed by law for filing the return. If the time for filing the return shall be extended, interest at the rate of six per cent per annum, from the time when the return was originally required to be filed, to the time of payment, shall be added and paid.

2. The tax may be paid with uncertified check, during such time and under such regulations as the Tax Commission shall prescribe, but if a check so received is not paid by the bank on which it is drawn, the taxpayer by whom such check is tendered shall remain liable for the payment of the tax and for all legal penalties, the same as if such check had not been tendered.

Sec. 501. *Examination of returns.* 1. As soon as practicable after the return is filed the Tax Commission shall examine it and compute the tax, and the amount so computed by the Tax Commission shall be the tax. If the tax found due shall be greater than the amount theretofore paid, the excess shall be paid to the Tax Commission within ten days after notice of the amount shall be mailed by the Tax Commission, and any overpayment of tax shall be returned within ten days after it is ascertained.

2. If the return is made in good faith and the understatement of the tax is not due to any fault of the taxpayer, there shall be no penalty or additional tax added because of such under-

statement, but interest shall be added to the amount of the deficiency at the rate of one per cent for each month or fraction of a month.

3. If the understatement is due to negligence on the part of the taxpayer, but without intent to defraud, there shall be added to the amount of the deficiency five per cent thereof, and in addition, interest at the rate of one per cent per month or fraction of a month.

4. If the understatement is false or fraudulent, with intent to evade the tax, the tax on the additional income discovered to be taxable shall be doubled and an additional one per cent per month or fraction of a month shall be added.

5. The interest provided for in this section shall in all cases be computed from the date the tax was originally due to the date of payment.

6. If the amount of tax found due as computed shall be less than the amount theretofore paid, the excess shall be refunded by the Tax Commission out of the proceeds of the tax retained by it as provided in this act.

Sec. 502. Corrections and changes. If the amount of the net income for any year of any taxpayer under this article as returned to the United States Treasury Department is changed or corrected by the Commissioner of Internal Revenue or other office of the United States or competent authority, such taxpayer, within ten days after receipt of notice of such change or correction, shall make return under oath or affirmation to the Tax Commission of such changed or corrected net income, and shall concede the accuracy of such determination or state wherein it is erroneous.

The Tax Commission shall ascertain, from such return and any other information in the possession of the Commission, the entire net income of such taxpayer for the fiscal or calendar year for which such change or correction has been made by such Commissioner of Internal Revenue or other officer or authority. The Tax Commission shall thereupon reaudit and restate the account of such taxpayer for taxes based upon the entire net

income for such fiscal or calendar year, such reaudit to be according to the entire net income so ascertained by the Tax Commission. The proceedings and determination of the Tax Commission in the making of such reassessment may be revised and readjusted and reviewed as in the case of an original assessment of the tax. If from such reassessment it appears that such taxpayer shall have paid under this article an excess of tax for the year for which such reassessment is made, the Tax Commission shall within thirty days refund the amount of such excess. If from such reassessment it appears that an additional tax is due from such taxpayer for such year, such taxpayer shall, within thirty days after notice has been given in by the Tax Commission pay such additional tax.

Sec. 503. *Additional Taxes.* If the Tax Commission discovers from the examination of the return or otherwise that the income of any taxpayer, or any portion thereof, has not been assessed, it may, at any time within two years after the time when the return was made due, assess the same and give notice to the taxpayer of such assessment, and such taxpayer shall thereupon have an opportunity, within thirty days, to confer with the Tax Commission as to the proposed assessment. The limitation of two years to the assessment of such tax or additional tax shall not apply to the assessment of additional taxes upon fraudulent returns. After the expiration of thirty days from such notification the Tax Commission shall assess the income of such taxpayer or any portion thereof which it believes has not theretofore been assessed and shall give notice to the taxpayer so assessed, of the amount of the tax and interest and penalties, if any, and the amount thereof shall be due and payable within ten days from the date of such notice. The provisions of this act with respect to revision and appeal shall apply to a tax so assessed. No additional tax amounting to less than one dollar shall be assessed.

Sec. 504. *Warrant for the collection of taxes.* If any tax imposed by this act or any portion of such tax be not paid within sixty days after the same become due, the Tax Commis-

sion shall issue an order under its hand and official seal directed to the sheriff of any county of the State, commanding him to levy upon and sell the real and personal property of the taxpayer, found within his county, for the payment of the amount thereof, with the added penalties, interest and the cost of executing the same and to return to the Tax Commission the money collected by virtue thereof by a time to be therein specified, not less than sixty days from the date of the order. The said sheriff shall thereupon proceed upon the same in all respects, with like effect, and in the same manner prescribed by law in respect to executions issued against property upon judgments of a court of record, and shall be entitled to the same fees for his service in executing the order, to be collected in the same manner. If an order be returned not satisfied in full, the Tax Commission shall have the same remedies to enforce the claim for taxes against the taxpayer as if the State had recovered judgment against the taxpayer for the amount of the tax.

Sec. 505. *Tax a debt.* Every tax imposed by this act, and all increases, interest and penalties thereon, shall become, from the time it is due and payable, a personal debt, from the person or persons liable to pay the same, to the State of North Carolina.

Sec. 506. *Action for recovery of taxes.* Action may be brought at any time by the Attorney General of the State, at the instance of the Tax Commission, in the name of the State, to recover the amount of any taxes, penalties and interest due under this act.

Sec. 507. *Tax upon settlement of fiduciary's account.* 1. No final account of a fiduciary shall be allowed by the probate court unless such account shows, and the judge of said court finds, that all taxes imposed by the provisions of this act upon said fiduciary, which have become payable, have been paid, and that all taxes which may become due are secured by bond, deposit or otherwise. The certificate of the Tax Commission and the receipt for the amount of the tax therein certified shall

be conclusive as to the payment of the tax, to the extent of said certificate.

2. For the purpose of facilitating the settlement and distribution of estates held by fiduciaries, the Tax Commission, with the approval of the Attorney General, may, on behalf of the State, agree upon the amount of taxes at any time due or to become due from such fiduciaries under the provisions of this act, and payment in accordance with such agreement shall be full satisfaction of the taxes to which the agreement relates.

ARTICLE VI

PENALTIES

Sec. 600. *Penalties.* 1. If any taxpayer, without intent to evade any tax imposed by this act shall fail to file a return of income or pay a tax, if one is due, at the time required by or under the provisions of this act, but shall voluntarily file a correct return of income and pay the tax due within sixty days thereafter, there shall be added to the tax an additional amount equal to five per cent thereof, but such additional amount shall in no case be less than one dollar and an additional one per cent for each month or fraction of a month during which the tax remains unpaid.

2. If any taxpayer fails voluntarily to file a return of income or pay a tax, if one is due, within sixty days of the time required by or under the provisions of this act, the tax shall be doubled, and such doubled tax shall be increased by one per cent for each fraction of a month from the time the tax was originally due to the date of payment.

3. The Tax Commission shall have power, upon making a record of its reasons therefor, to waive or reduce any of the additional taxes or interest provided in subdivisions 1 and 2 of this section, or in subdivisions 2, 3, and 4 of Section 501.

4. If any taxpayer fails to file a return within sixty days of the time prescribed by this act, any judge of the Superior Court, upon petition of the Tax Commission, or of any ten taxable

residents of the State, shall issue a writ of mandamus requiring such person to file a return. The order of notice upon the petition shall be returnable not later than ten days after the filing of the petition. The petition shall be heard and determined on the return day or on such day thereafter as the Court shall fix, having regard to the speediest possible determination of the case, consistent with the rights of the parties. The judgment shall include costs in favor of the prevailing party. All writs and processes may be issued from the clerk's office in any county and, except as aforesaid, shall be returnable as the Court shall order.

5. Any person who, without fraudulent intent, fails to pay any tax or to make, render, sign or verify and return, or to supply any information, within the time required by or under the provisions of this act, shall be liable to a penalty of not more than one thousand dollars, to be recovered by the Attorney General, in the name of the people, by action in any court of competent jurisdiction.

6. Any person or officer or employee of any corporation, or member or employee of any partnership, who, with intent to evade any requirement of this act, or any lawful requirement of the Tax Commission thereunder, shall fail to pay any tax or to make, sign, or verify any return, or to supply any information required by or under the provisions of this act, or who, with like intent, shall make, render, sign, or verify any false or fraudulent return or statement, or shall supply any false or fraudulent information, shall be liable to a penalty of not more than one thousand dollars, to be recovered by the Attorney General in the name of the people, by action in any court of competent jurisdiction, and shall also be guilty of a misdemeanor, and shall, upon conviction, be fined not to exceed one thousand dollars or be imprisoned not to exceed one year, or both, at the discretion of the Court.

7. The Attorney General shall have the power, with the consent of the Tax Commission, to compromise any penalty for which he is authorized to bring action under subdivisions

5 and 6 of this section. The penalties provided by such subdivisions shall be additional to all other penalties in this act provided.

8. The failure to do any act required by or under the provisions of this act shall be deemed an act committed in part at the office of the Tax Commission in Raleigh. The certificate of the Tax Commission to the effect that a tax has not been paid, that a return has not been filed, or that information has not been supplied, as required by or under the provisions of this act, shall be prima facie evidence that such tax has not been paid, that such return has not been filed, or that such information has not been supplied.

9. If any taxpayer who has failed to file a return, or has filed an incorrect or insufficient return, and has been notified by the Tax Commission of his delinquency, refuses or neglects within twenty days after such notice to file a proper return, or files a fraudulent return, the Tax Commission shall determine the income of such taxpayer, according to its best information and belief, and assess the same at not more than double the amount so determined. The Tax Commission may, in its discretion, allow further time for the filing of a return in such case.

ARTICLE VII

REVISION AND APPEAL

Sec. 700. *Revision by Tax Commission.* A taxpayer may apply to the Tax Commission for revision of the tax assessed against him, at any time within one year from the time of the filing of the return or from the date of the notice of the assessment of any additional tax. The Tax Commission shall grant a hearing thereon, and if, upon such hearing, it shall determine that the tax is excessive or incorrect, it shall resettle the same according to the law and the facts and adjust the computation of tax accordingly. The Tax Commission shall notify the taxpayer of its determination and shall refund to the taxpayer the amount, if any, paid in excess of the tax found by it to be due.

If the taxpayer has failed, without good cause, to file a return within the time prescribed by law, or has filed a fraudulent return, or, having filed an incorrect return, has failed, after notice, to file a proper return, the Tax Commission shall not reduce the tax below double the amount for which the taxpayer is found to be properly assessed.

Sec. 701. *Appeal.* Any taxpayer may file formal exceptions to any findings by the State Tax Commission with respect to his taxable income, and upon such exceptions being overruled, any such taxpayer shall have the right, upon the payment of the amount of tax found by the State Tax Commission to be due, and upon filing bond for costs in the sum of two hundred dollars, to have the record in such case certified to the Superior Court of the county in which the taxpayer resides, or has his principal place of business, within thirty days after notice by the Tax Commission of its determination, given as provided in section 700 of this act. Thereupon, appropriate proceedings shall be had and the relief, if any, to which the taxpayer may be found entitled may be granted and any taxes, interest or penalties paid, found by the Court to be in excess of those legally assessed, shall be ordered refunded to the taxpayer, with interest from time of payment.

The General Assembly of North Carolina do enact:

Section 1. That in determining the taxable income of a corporation engaged in the business of operating a railroad under section two hundred and two of the act to raise revenue, in the case of a railroad located entirely within this State, the net operating income shall be increased or decreased to the extent of any credit or debit balance received or paid, as the case may be, on account of car hire; and when any railroad is located partly within and partly without this State, then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid, as the case may be, on account of car hire.